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Supreme Court, U.S.
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In The
Supreme Court of The United States
October Term 1997

JOHN M. SHANKLIN
Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION
Respondent.

Petition For A Writ Of Certiorari
To The United States Court of
Appeals For The Second Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Should this Court invoke its power of supervision and reverse the decision of the United States Court of Appeals for the Second Circuit, which affirms a ruling by the United States District Court for the Southern District of New York denying Petitioner's motion to vacate a default judgment, where the Second Circuit's decision so far departs from the accepted and usual course of judicial proceedings as to require this Court's intervention in order to prevent gross miscarriage of justice where Petitioner has been denied his day in court on the merits because unbeknownst to Petitioner, Petitioner's former counsel failed to respond to the complaint, concealed his misconduct from Petitioner, and misled Petitioner into believing a false scenario about the status of the case, and where the trial court nevertheless imputed the former counsel's conduct to Petitioner despite the former counsel's breach of his fiduciary duty to Petitioner?

LIST OF PARTIES TO THE PROCEEDINGS IN THE COURT BELOW

1. Defendant-Appellant John M. Shanklin
2. Plaintiff-Appellee Securities and Exchange Commission

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit that gives rise to this petition, along with that court's ruling on the petition for rehearing and suggestion for rehearing in banc, and the opinion of the United District Court for the Southern District of New York that triggered the appeal, are contained in the Appendix of this Petition.

STATEMENT OF JURISDICTION

On July 29, 1996 the United States District Court for the Southern District of New York issued its Opinion and Order denying Defendant John M. Shanklin's Motion to Set Aside Default Judgment. That ruling was affirmed by the United States Court of Appeals for the Second Circuit on March 3, 1998. The Second Circuit denied a petition for rehearing and suggestion for rehearing in banc on May 18, 1998.

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTES AND RULES INVOLVED IN THIS CASE

1. Fed. R. Civ. P. 55(c) provides:

> "For good cause shown the court may set aside an entry of default and, if a judgment by default has been entered, may likewise set it aside in accordance with Rule 60(b)."

2. Fed. R. Civ. P. 60(b) provides in relevant part:

> "On motion and upon such terms as are just, the court may relieve a party or a party's legal representative from a final judgment, . . . for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; . . . (6) any other reason justifying relief from the operation of the judgment. . . ."

STATEMENT OF THE CASE

This case arises out of a ruling by the United States District Court for the Southern District of New York denying a motion to vacate a default judgment entered against Defendant -Petitioner John M. Shanklin ("Shanklin"). The district court had jurisdiction over the case pursuant to 28 U.S.C. § 1331 (federal question). Final judgment was entered in accordance with Fed. R. Civ. P. 54(b) on September 11, 1995. A timely motion to vacate the default judgment was made pursuant to Fed. R. Civ. P. 60(b), and the district court filed its ruling denying the motion to vacate the default judgment on July 26, 1996.

On September 30, 1994, plaintiff Securities and Exchange Commission ("SEC") filed the underlying federal securities action against several defendants, including Petitioner Shanklin, in connection with the issuance of prospectuses for three initial public offerings and a private placement memorandum involving certain corporate entities founded and controlled by defendant Robert J. McNulty (the "McNulty Entities"). The SEC alleged wrongdoing concerning the public disclosures relating to the McNulty Entities. However, none of the relevant disclosures was prepared with Petitioner Shanklin's assistance; and, indeed, the disclosures preceded Shanklin's employment with the McNulty entities, which commenced in October 1990.

Shanklin was charged with assisting or participating in the knowing or reckless non-disclosure of certain prior

improper corporate diversions of funds belonging to the McNulty entities, as well as improper accounting for sh ·d costs and joint expenses with various entities. During the SEC's investigation and prior to Shanklin being named in the SEC's complaint, Shanklin retained an attorney, Fred Rucker ("Rucker"), who represented himself as experienced in the handling of SEC litigation. Rucker immediately painted an optimistic picture to Shanklin of the prospects of a negotiated resolution of the case. Rucker told Shanklin that, based upon his conversations with the SEC's staff representative, he believed the SEC did not intend to seek monetary damages from Shanklin, but at most would seek only "minor disciplinary action" in the form of an injunction. Rucker also told Shanklin that the SEC had informed Rucker that the SEC viewed Shanklin as being of one of the least culpable of the potential defendants, and that Rucker was in settlement negotiations with the SEC even prior to the filing of the complaint.

After the SEC filed its complaint and served it on Shanklin, Shanklin promptly turned it over to Rucker. Unbeknownst to Shanklin, however, Rucker's strategy for a negotiated settlement with the SEC foundered. Despite this, Rucker never filed a response to the complaint, and never informed Shanklin of the default. Instead, Rucker led Shanklin to believe that he was in fruitful negotiations with the SEC and was competently handling the case. Rucker sent several letters to Shanklin indicating promise for settlement, and lulled Shanklin into believing that he had the case well in

hand. In fact, Shanklin did not receive any adverse notices at all about the case until he learned of the entry of the default judgment. He never received any notices or warnings that a default was impending.

The evidence submitted to the district court indicated that Rucker was warned several times by the SEC that it would be seeking a default judgment against Shanklin. Nevertheless, Rucker failed to act. As a consequence, a default judgment was entered against Shanklin. The evidence also indicates that Rucker's law practice was in some disarray due to Rucker's law firm having dissolved. Rucker was also apparently involved in a lengthy jury trial during the period preceding the entry of the default judgment.

In ruling on Shanklin's motion for relief from the default judgment, the district court determined that Rucker's conduct in causing the default was not merely negligent, but was "willful." The district court then also found that Rucker's "willful" misconduct should be imputed onto Shanklin because Shanklin purportedly had made no showing that he had been diligent in inducing Rucker to fulfill his duty as an attorney. The district court further found that Shanklin had failed to demonstrate that he had a meritorious defense.

The Second Circuit affirmed the district court's ruling. The court of appeals agreed that Rucker's conduct was "willful" rather than merely negligent, and agreed that such conduct should be imputed to Shanklin. SEC v. McNulty, 1998 U.S. App. Lexis 4031, at 17-25. The court reasoned that "Shanklin had made no showing of diligence that would

warrant relieving him of the default judgment." Id. at 24. The court suggested that Shanklin had failed to discuss the case with Rucker or to monitor the progress of the case, and, therefore, had failed to induce diligence in his attorney's handling of the case. Id. The court also concluded that the district court properly exercised its discretion in finding that Shanklin had not presented a meritorious defense. Id. at 25-28. On May 18, 1998, the court denied a petition for rehearing and a suggestion for rehearing in banc.

REASONS FOR ALLOWANCE OF PETITION

Shanklin's motion to vacate the default judgment under Fed. R. Civ. P. 60(b) was denied by the trial court essentially for two reasons: First, the court ruled that the conduct of Shanklin's former attorney which caused the default judgment was "willful," and that Shanklin had failed to show that he diligently monitored his former attorney's conduct. Therefore, according to the trial court, such conduct was imputable to Shanklin. Second, the court ruled that Shanklin did not present a meritorious defense to the SEC charges. The Second Circuit affirmed this ruling thereby effectively depriving Shanklin of his day in court on the merits.

This Court should invoke its power of supervision and reverse the Second Circuit's decision because that decision operates in a fundamentally unfair manner to imperil the opportunity of a relatively innocent defendant to obtain relief from default. Fed. R. Civ. P. 60(b) states, in relevant part, that: "On motion and upon such terms as are just, the court may relieve a party or a party's legal representative from a final judgment ... for ... (1) ... excusable neglect; .... or (6) any other reason justifying relief from the operation of the judgment. ..." Under the Second Circuit's decision, the court focuses only on whether the conduct of the party's legal representative amounted to "excusable neglect." Because the court finds the conduct of the attorney to have been "willful," such conduct is imputed to the defendant/client, even if the

defendant's own conduct was, at most, only negligent, and not willful. The defendant's only culpability, if it can be called such, is that the defendant failed to "diligently" monitor the conduct of his counsel.

The net effect of the decision is to impose a duty on defendants to monitor the manner in which the attorney is handling the case. While this, in itself, is not necessarily undesirable, it raises the question why, as in the instant case, should a relatively innocent defendant/client be straddled with the consequences of the willful misconduct of his attorney -- especially where the attorney misled the client, induced the client into a false sense of security, and the client never had any indication of the non-action of the attorney.[1] The Second Circuit's decision has the potential of eroding the public confidence in the judicial system. In the first instance, the decision is illogical because it imputes "willful" conduct of the attorney onto a relatively faultless client while ostensibly excusing the client from the consequences of default if the attorney's conduct was merely "negligent." That result is "topsy turvy" because an attorney/agent who has engaged in willful misconduct has, in effect, abandoned his client's cause and, accordingly, his adverse acts should not be imputable to

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1/ As shown in the record below, Shanklin's attorney, Rucker, even sent a purported motion to set aside the default to Shanklin, and billed him for the preparation of the motion, to lull Shanklin into believing appropriate action was being taken.

his principal. See, e.g., In re Mediators, Inc., 105 F.3d 822, 827 (2d Cir. 1997); Arlinghaus v. Ritenour, 622 F.2d 629 (2d Cir.), cert. Denied, 449 U.S. 1013 (1980). Further, the Second Circuit's decision below considerably narrows that part of Rule 60(b) which states that "the court may relieve a party ... from a final judgment ... for ... (1) ... excusable neglect ... or (6) any other reason justifying relief from the operation of the judgment. ..." If the client's only fault was that he or she was less than diligent in monitoring the conduct of his or her attorney, the client should still be able to avail him or herself of relief under Rule 60(b) for his own excusable neglect or because, under subdivision (6) of the Rule, justice so demands.

Second, the decision imposes a duty upon a client (who is ab initio unlikely to know that such a duty exists) to constantly monitor and inquire into the manner of the attorney's handling of the case. In that respect, the Second Circuit's decision fails to countenance the realities of litigation. In reality, few clients are sophisticated enough to effectively monitor an attorney to prevent him or her from defaulting the case. Furthermore, the Second Circuit's decision improperly cautions clients against reliance on the attorney's judgment and skill, and, for that reason, has the tendency to erode the attorney-client relationship, a relationship which has traditionally been viewed as based on utmost good faith and confidence.

Under the Second Circuit's formulation of the rule denying a less than diligent client the right to set aside a

default judgment, the client is straddled with an amorphous "duty" to diligently induce the attorney to fulfill his professional obligations. Under the court's rule, the client is not justified merely to rely on the attorney's initial assurances of his or her skill in the handling of the case, or on the attorney's assessment that the case will be easily resolved through settlement or negotiation. Where the attorney, as in the instant case, breaches his fiduciary obligations to the client, and falsely lulls the client into believing that the case is being settled and that resolution will potentially be achieved, the Second Circuit's decision squarely places the risk of the consequences of that mistaken belief on the innocent client.

Moreover, the duty imposed by the Second Circuit on defendants to diligently monitor their attorneys' conduct is unlikely to yield to equal application among different defendants. A different standard would have to be applied to different defendants depending on their level of sophistication. The inherent subjectiveness of the determination of "diligence" renders the rule subject to capricious application.

Where, as here, the former counsel leads the client to falsely believe that the case is being competently handled, and that the defendant has little culpability, and then fails to inform the client of the true status of the case, including that the case was defaulted, it is harsh indeed for the courts to allow the attorney's conduct to devolve onto the relatively faultless client.

CONCLUSION

This Court should, therefore, exercise its power of supervision and reverse the Second Circuit's decision.

August 7, 1998

Respectfully Submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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August Term, 1997
(Argued: November 17, 1997 Decided: August 12, 1998)
Docket No. 97-6122

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellee,

- v. -

ROBERT J. McNULTY, GEORGE G. HANDGIS, FRANKLIN D. ROBERTS, JOHN M. SHANKLIN and W.N. THOMPSON,
Defendants,

JOHN M. SHANKLIN,
Defendant-Appellant.

Before: KEARSE and CARDAMONE, Circuit Judges, and LEISURE, District Judge*.

Appeal challenging an order of the United States District Court for the Southern District of New York, Michael

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*Honorable Peter K. Leisure, of the United States District Court for the Southern District of New York, sitting by designation.

B. Mukasey, Judge, denying motion to vacate a default judgment following counsel's willful neglect, where appellant failed to persuade the court that he was not culpable and had a meritorious defense.

Affirmed.

SUSAN K. STRAUS, Washington, D.C. (Richard H. Walker, General Counsel, Jacob H. Stillman, Associate General Counsel, Susan Ferris Wyderko, Assistant General Counsel, Paul Gonson, Solicitor, Washington, D.C., on the brief), for Plaintiff-Appellee.

GREGG A. RAPOPORT, Los Angeles, California (Jack I. Samet, Baker & Hostetler, Los Angeles, California, on the brief), for Defendant-Appellant.

KEARSE, Circuit Judge:

Defendant John M. Shanklin, against whom a default judgment was entered in the United States District Court for the Southern District of New York for failure to answer the complaint filed by plaintiff Securities and Exchange Commission ("SEC" or the "Commission"), challenges the order of that court, Michael B. Mukasey, Judge, denying his motion to vacate the default judgment. In denying the motion, the district court ruled that Shanklin had failed to show that the default was not willful and that he was not culpable, and had failed to proffer a meritorious defense to the SEC's claims. On appeal, Shanklin contends principally that

the district court erred in imputing his attorney's neglect to him and in failing to resolve doubts as to the merits of Shanklin's defenses in his favor. Finding no merit in these contentions, we affirm.

I. BACKGROUND

The present action was commenced against Shanklin and others, including defendant Robert J. McNulty, in connection with several corporations controlled by McNulty, which in 1988-1990 had raised $78 million through various public and private offerings of securities. According to the complaint, portions of these moneys were diverted to McNulty and other entities he controlled, an intended use that the defendants had fraudulently concealed. Shanklin, during part of the pertinent period, was an officer and director of two McNulty companies: Auto Giant, Inc. ("Auto Giant"), of which he was executive vice president, chief executive officer, and chief operating officer; and Auto Depot, Inc. ("Auto Depot"), of which he was president, chief executive officer, chief operating officer, and chief administrative officer. In those capacities, Shanklin was responsible for the two companies' internal books and records and for their annual and quarterly filings with the SEC. The complaint alleged that company books and certain of the SEC filings misrepresented or falsely concealed material transactions, and that Shanklin knew, or recklessly failed to know, of those misrepresentations or concealments.

A. The Default

The present action was commenced on September 30, 1994, following a lengthy SEC investigation in which Shanklin had been represented by Fred Rucker, Esq. The complaint described the conduct of the defendants in connection with the McNulty companies' securities offerings and, to the extent pertinent here, alleged that Shanklin had engaged in, and unless enjoined would continue to engage in, conduct violative of §§ 10(b), 13(a), and 13(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78j(b), 78m(a), and 78m(b) (1994), and various SEC Rules promulgated thereunder, including Rule 10b-5, 17 C.F.R. § 240.10b-5 (1997). The SEC requested, inter alia, the imposition of a civil fine and the entry of a permanent injunction forbidding such violations. On October 28, Shanklin acknowledged receipt of a copy of the complaint and waived service of summons. He forwarded the complaint to Rucker as his attorney.

Shanklin's time to answer the complaint was extended to December 13, 1994, and then to December 27. Rucker did not file an answer on behalf of Shanklin or move to dismiss the action. Nor did he attend any of the pretrial conferences called by the district court or, despite co-counsel's urging, join in the other defendants' motions to dismiss or to change venue. Although Rucker and the SEC discussed settlement of the case against Shanklin, those discussions proved fruitless. In April 1995, with Shanklin's answer some four months

overdue, the SEC sent Rucker a letter stating that if the answer were not forthcoming the Commission would seek entry of a default. The SEC sent Rucker similar letters in May and June. No answer was ever filed. The SEC moved for entry of a default in August 1995.

The district court, receiving no response to the motion, entered a default judgment against Shanklin on September 11, 1995. The judgment enjoined Shanklin from violating §§ 10(b), 13(a), and 13(b) of the 1934 Act, 15 U.S.C. §§ 78j(b), 78m(a) and 78m(b), and several SEC Rules. The judgment directed that further proceedings be held before a magistrate judge to determine the amount of Shanklin's civil fine.

The SEC served copies of the default judgment on both Rucker and Shanklin. Shanklin eventually returned to the SEC an affidavit acknowledging his receipt of the judgment. Rucker wrote to SEC Branch Chief James P. Bodovitz, stating that he had believed settlement negotiations were ongoing and threatening to "seek relief from the default." (Letter from Fred Rucker to James P. Bodovitz, dated September 29, 1995). Bodovitz wrote back, dismissing Rucker's position as "patently incorrect" and pointing out that

> I wrote letters to you in . . . regard [to the SEC's intention to seek a default judgment] on April 11, 1995, April 26, 1995, May 11, 1995, June 1, 1995, and June 25, 1995. You responded to none of these letters.

(Letter from James P. Bodovitz to Fred Rucker, dated October 2, 1995.)

In mid-November 1995, Rucker filed Shanklin's opposition to the request for monetary sanctions. That submission stated that "Shanklin will be filing within the next two days a motion for relief from [the] default." (Opposition of Defendant John M. Shanklin to Imposition of Civil Monetary Penalties, dated Nov. 15, 1995, at 2 n.1.) In a letter sent contemporaneously to Shanklin, Rucker stated that he was "in the process of preparing a motion for relief from the default." (Letter from Fred Rucker to John M. Shanklin, dated November 17, 1995.) Rucker never filed such a motion.

B. Denial of the Motion To Vacate

In May 1996, Shanklin substituted new counsel and moved under Fed. R. Civ. P. 60(b)(1) and 60(b)(6) to vacate the default judgment. The motion argued principally (a) that Rucker alone was responsible for Shanklin's failure to answer the complaint, (b) that the SEC could not prove its claims against Shanklin because it could not establish his scienter, and (c) that the entry of injunctive relief against him was inappropriate. In support of the motion, Shanklin submitted his affidavit stating, inter alia, that until his new attorneys obtained Rucker's files, Shanklin had been unaware of the SEC's threats to move for default if he did not answer. Further, Shanklin stated that after the default judgment was entered he believed Rucker would move to vacate the default, because Rucker promised to do so and in fact thereafter billed

Shanklin for work in connection with the promised motion. (Affidavit of John M. Shanklin in Support of Motion To Set Aside Default Judgment, dated May 16, 1996 ("Shanklin Aff."), ¶¶ 2-24.) Shanklin's affidavit also described his involvement with the McNulty companies, denying any role in the public offerings, explaining his conduct in connection with the SEC reports as to certain intra-organization money transfers, and maintaining that he had had no knowledge of any misstatements in corporate filings or other documents. (Id. ¶¶ 25-34.) In arguing that there were no grounds for the entry of an injunction against him, Shanklin stated, inter alia, that prior to joining the McNulty companies, he "had held executive positions and was responsible for the financial, administrative and operational functions within several major publicly-held corporations" (id. ¶ 36), and that in his "more than 20 years of senior management experience, and over 30 years of overall corporate management," he had "prepared and signed numerous securities filings, and apart from this case, ha[d] not once even been criticized or questioned about the accuracy or completeness of the[] disclosures" (id. ¶ 37).

The SEC opposed the motion to vacate the default, submitting various exhibits to show both willfulness and the lack of merit in Shanklin's defenses. The Commission argued that willfulness was revealed by the sequence of events, including the Commission's repeated letters to Rucker advising him that the Commission was about to move for a default, Rucker's inaction in the face of those warnings, and the lack of any motion to vacate the default judgment until

some eight months after its entry. As to Shanklin's defense of lack of scienter, the Commission argued that § 13 and the SEC Rules thereunder, which require publicly-traded companies to keep records that accurately and fairly reflect their dispositions of assets, and to file with the Commission quarterly and annual reports containing sufficient information to make the reports not misleading, are provisions under which civil liability may be imposed without proof of scienter. With respect to its claims under § 10(b) and Rule 10b-5, of which scienter is an element, the Commission submitted, inter alia, excerpts from deposition testimony by Michael A. Cross, a member of the law firm that had acted as outside counsel to Auto Giant and Auto Depot, describing a conversation in which Cross had questioned Shanklin as to the veracity of a document that he advised Shanklin not to file with the SEC, and that Shanklin nonetheless proceeded to file.

In an Opinion and Order dated July 26, 1996 ("Opinion"), the district court denied Shanklin's motion to vacate. The court considered "(1) whether the default was willful, (2) whether setting aside the default would prejudice the [SEC], and (3) whether [Shanklin] ha[d] presented a meritorious defense to the action," noting that it would "apply these factors generously, and resolve any doubts in favor of the defaulting party." Opinion at 6. Following a thorough analysis of the record, described below, the court found that the default was willful and should be imputed to Shanklin; that the delay occasioned by setting aside the default would

prejudice the SEC, albeit only slightly; and that Shanklin had not shown that he had a meritorious defense to the SEC's claims.

> As to willfulness, the court stated that Rucker's failure to respond to the complaint, his failure to appear at pretrial conferences, and his failure to move to set aside the default judgment despite billing his client for preparing a motion, all amount to grossly negligent behavior that cannot reasonably be characterized as excusable neglect. In addition, there is no evidence that Shanklin diligently induced Rucker to fulfill his duty. Shanklin does not show that he discussed the suit with Rucker at any time between October 1994 and September 1995. Absent Shanklin's diligent efforts to induce Rucker to fulfill his duty, Shanklin is bound by Rucker's willful conduct. Rucker's egregious conduct may warrant a malpractice suit, but Shanklin's failure to monitor that conduct does not justify relieving him of the default judgment.

Id. at 8-9. As to prejudice to the Commission, the court noted that reopening the case against Shanklin would "require it to conduct discovery with many of the same individuals and entities as it has already done in preparation for the Handgis trial," which was imminent. Id. at 10. The court regarded this

prejudice as "slight[]," however, because the "SEC ha[d] not shown that such delay would result in a loss of evidence or provide opportunities for fraud or collusion." Id.

As to the quality of Shanklin's scienter defense, the court found that his disclaimers were irrelevant to the SEC's claims under §§ 13(a) and (b) because scienter is not an element of those claims. The court stated that, in light of the fact that "Shanklin . . . admittedly filed false and incomplete disclosure forms with the SEC, he is liable under" § 13. Opinion at 15. The court rejected as immaterial Shanklin's argument that one of the forms in question had not been prepared by him, observing that

> Shanklin signed the form, and as the chief officer of Auto Depot and Auto Giant, and a sophisticated businessman, he is held responsible for the accuracy of the information therein. Shanklin cannot escape that responsibility by entrusting the preparation of the filings to a professional.

Id. at 16.

As to the claims under § 10(b) and Rule 10b-5, of which scienter is an element, the court found Shanklin's pleas of innocent ignorance insufficient in light of both Cross's deposition testimony and Shanklin's own affidavit's descriptions of events that should have been recognized by Shanklin, given his extensive business experience, as signs of fraud:

> Shanklin admits he drafted the false Auto

Giant quarterly report in November 1990 ("the November 1990 filing"), and admits also that he knew McNulty wanted to conceal a transfer of $805,000 from Auto Giant to Centaur [a McNulty company]. ([Shanklin Aff.] ¶¶ 30(b), 30(c)) According to Shanklin, in November 1990, when he learned of the $805,000 transfer to Centaur, he asked McNulty for information about it. McNulty told him not to disclose the transaction, refused to provide further information, and called him derogatory names. (Id. ¶ 30(b)) In a meeting later that day or the following day, Shanklin told McNulty he would nevertheless report the transaction on the November 1990 filing, (Id.) and McNulty allegedly told him that the transfer's purpose was to fund deposits on real estate leases. (Id. ¶ 30(c)) McNulty referred Shanklin to defendant Willard Thompson, but Thompson "was evasive and refused to provide detail about Centaur's purported use of the Auto Giant funds to secure real estate leases. For example, he would not tell me who the landlords on the leased properties were, or the terms of the leases." (Id. ¶ 30(e))

In addition, in his deposition on April 3, 1996,

Michael Cross, an attorney at Cooper & Dempsey, testified that he reviewed Shanklin's draft of Auto Giant's November 1990 filing, questioned its truthfulness, requested an explanation from Shanklin, and advised Shanklin that the document should not be filed with the Commission. (Bodovitz Decl. ¶ 7, Ex. 4) Despite Thompson's evasive response and Cross's advice, Shanklin filed the form with the SEC.

Although Shanklin claims he did not learn the information McNulty had given him was incorrect until after an internal investigation later disclosed that the funds actually went to Global [a McNulty company] to buy securities for Centaur (id. ¶ 30(f)), Shanklin had good reason to be suspicious of McNulty's statement when Thompson showed reluctance to provide further information. That McNulty and Thompson both refused to provide him with relevant information should have alerted Shanklin to the likelihood of material omissions and misrepresentations in the November 1990 filing that he prepared. Shanklin cannot "escape liability for fraud by closing his eyes to what he saw and could readily understand." . . . Shanklin's conscious avoidance of knowledge satisfies the scienter requirement. . . .

> In sum, Shanklin does not sufficiently demonstrate that he lacked the requisite scienter so as to present a meritorious defense that would relieve him from the default judgment. While he may not have known the

> precise details of the transactions McNulty sought to conceal, or the reason McNulty sought to conceal them, he knew that the disclosure forms he prepared and signed were inaccurate and omitted material information.

Opinion at 12-14.

The district court concluded that Shanklin had not shown good cause for vacating the default judgment, and it therefore denied the motion.

Eventually, the magistrate judge recommended that Shanklin be required to pay a civil fine of $7,500. The district court, in an order dated March 20, 1997 ("March 1997 Order"), adopted that recommendation, noting that neither of the parties had filed any objection. Thereafter, the case was closed.

Shanklin has filed a notice of appeal, stating that he is appealing from both the order denying his motion to vacate the default and the March 1997 Order adopting the magistrate judge's recommendation for a $7,500 civil fine. We do not address the latter order, both because in the absence of a timely objection in the district court to the recommendation of the magistrate judge no issue is preserved for review, see, e.g., Wesolek v. Canadair Ltd., 838 F.2d 55, 58 (2d Cir. 1988), and because Shanklin has not addressed the March 1997 Order in his brief on appeal, see, e.g., Fed. R. App. P. 28(a)(4); Day v. Morgenthau, 909 F.2d 75, 76 (2d Cir. 1990).

II. DISCUSSION

In challenging the district court's refusal to vacate the default, Shanklin argues principally (1) that his attorney's conduct was not willful, and even if willful it should not have been imputed to him; and (2) that his lack of scienter constitutes a meritorious defense to the securities fraud charges against him. For the reasons below, we reject his contentions.

Rule 60(b) provides, in pertinent part, that the district court may grant a motion for relief from a judgment on the ground of "excusable neglect," Fed. R. Civ. P. 60(b)(1), or for "any other reason justifying relief from the operation of the judgment," Fed. R. Civ. P. 60(b)(6); see also Fed. R. Civ. P. 55(c) (providing that default judgments may be set aside in accordance with Rule 60(b)). A motion to vacate a default judgment is addressed to the sound discretion of the district court, see, e.g., Enron Oil Corp. v. Diakuhara, 10 F.3d 90, 95 (2d Cir. 1993), and we will not reverse the denial of such a motion except for abuse of discretion, see, e.g., id.; American Alliance Insurance Co. v. Eagle Insurance Co., 92 F.3d 57, 62 (2d Cir. 1996) ("American Alliance"); Davis v. Musler, 713 F.2d 907, 913 (2d Cir. 1983).

In deciding a motion to vacate a default judgment, the district court is to be guided principally by three factors: (1) whether the default was willful, (2) whether the defendant demonstrates the existence of a meritorious defense, and (3) whether, and to what extent, vacating the default will cause

the nondefaulting party prejudice. See, e.g., American Alliance, 92 F.3d at 59; Davis v. Musler, 713 F.2d at 915. An absence of prejudice to the nondefaulting party would not in itself entitle the defaulting party to relief from the judgment. "[C]ourts have an interest in expediting litigation, [and] abuses of process may be prevented by enforcing those defaults that arise from egregious or deliberate conduct," American Alliance, 92 F.2d at 61; the district court thus has discretion to deny the motion to vacate if it is persuaded that the default was willful and is unpersuaded that the defaulting party has a meritorious defense, see, e.g., Commercial Bank of Kuwait v. Rafidain Bank, 15 F.3d 238, 244 (2d Cir. 1994); cf. Marziliano v. Heckler, 728 F.2d 151, 157 (2d Cir. 1984) (same with respect to motion to vacate default pursuant to Rule 55(c)).

On this appeal, the principal challenges are to the court's rulings that the default was willful and that Shanklin did not proffer a meritorious defense.

A. Willfulness

The issue of willfulness in the present case comprises two questions: (1) whether Rucker's failure to file an answer to the complaint was the result of a shortcoming more culpable than negligence or even gross negligence, and (2) whether that shortcoming was appropriately attributed to Shanklin. The district court properly answered both questions in the affirmative.

We have interpreted "willfulness," in the context of a default, to refer to conduct that is more than merely negligent or careless. See, e.g., American Alliance, 92 F.2d at 61 (default due to filing mistake by defendant's in-house counsel's clerk, held not willful); Davis v. Musler, 713 F.2d at 915-16 (default due to failure to note that complaint in second suit, served simultaneously with subpoenas and deposition notices in similar first suit, initiated a new lawsuit, may be found nonwillful); Enron Oil Corp. v. Diakuhara, 10 F.3d at 97 (failure to answer second amended complaint should be held nonwillful if pro se defendant, who had timely answered prior complaints and promptly opposed motion to enter default, did not, as he claimed, receive second amended complaint).

On the other hand, the court may find a default to have been willful where the conduct of counsel or the litigant was egregious and was not satisfactorily explained. See, e.g., American Alliance, 92 F.2d at 60-61 (discussing cases). Thus, defaults have been found willful where, for example, an attorney failed, for unexplained reasons, to respond to a motion for summary judgment, see United States v. Cirami, 535 F.2d 736, 739 (2d Cir. 1976) ("Cirami I"); or failed, for flimsy reasons, to comply with scheduling orders, see, e.g., Chira v. Lockheed Aircraft Corp., 634 F.2d 664, 666 (2d Cir. 1980); or failed, for untenable reasons, after defendants had "purposely evaded service for months," to answer the complaint, Commercial Bank of Kuwait v. Rafidain Bank, 15 F.3d at 243-44; or failed, for incredible reasons, to appear for

a scheduled pretrial conference and unaccountably delayed more than 10 months before moving to vacate the ensuing default, see Dominguez v. United States, 583 F.2d 615, 618 (2d Cir. 1978) (per curiam), cert. denied, 439 U.S. 1117 (1979).

As the record in the present case reveals, Shanklin was served with the complaint in October 1994 and acknowledged its receipt. His answer was due in December 1994, but no answer was filed. The SEC wrote Rucker in April 1995, stating that if he did not file Shanklin's answer promptly thereafter, the Commission would move for entry of a default. The Commission thereafter sent Rucker additional letters giving the same warning. There can be no suggestion that Rucker did not receive these letters; Shanklin's new counsel found in Rucker's files what appears to be a copy of a response to one such letter, stating that Shanklin's answer would be filed within two days. The record contains no affidavit from Rucker offering any explanation for his conduct. Shanklin himself states that the failure to file his answer was the result of "Rucker's outright disregard for the repeated warnings by the SEC that the SEC intended to seek entry of Shanklin's default" (Shanklin brief on appeal at 24; Shanklin Memorandum of Law in Support of Motion to Set Aside Default Judgment ("Shanklin Memorandum") at 22), conduct that was "outrageous" (Shanklin Memorandum at 23).

The district court's finding that Rucker's conduct was egregious is thus amply supported. There can be no question

on this record that the district court was correct in concluding that the neglect was not excusable and that the default was willful. Accordingly, we turn to the question of whether the willful default was permissibly attributed to Shanklin himself.

Normally, the conduct of an attorney is imputed to his client, for allowing a party to evade "the consequences of the acts or omissions of []his freely selected agent" "would be wholly inconsistent with our system of representative litigation, in which each party is deemed bound by the acts of his lawyer-agent." Link v. Wabash R.R. Co., 370 U.S. 626, 633-34 (1962). Thus, in the context of a default judgment, we "ha[ve] rather consistently refused to relieve a client of the burdens of a final judgment entered against him due to the mistake or omission of his attorney." Cirami I, 535 F.2d at 739; see, e.g., Chira v. Lockheed Aircraft Corp., 634 F.2d at 666; Dominguez v. United States, 583 F.2d at 618. In Cirami I, a default had been entered following defendants' failure to respond to the government's motion for summary judgment. We affirmed the denial of the motion to vacate because the defendants, one of whom was "an experienced businessman," stated merely that the reason for counsel's failure was "unknown," 535 F.2d at 739, and the defendants provided no evidence to suggest that they had ever made any efforts to determine that counsel was tending to the lawsuit. We stated:

> We have been provided with no affidavit of [the former attorney] which would cast any light on the circumstances of his failure to contest the government's motion for partial

> summary judgment. Neither have we received any affidavits from present counsel or [sic] appellants which would indicate what efforts, if any, have been made to elicit [the former attorney's] testimony, either voluntarily or under subpoena. . . . [T]here is no indication that any efforts were made by Cirami or his wife to ascertain at the time the status of the matter or the activity, if any, of his then-counsel. . . .
>
> . . . .
>
> [T]here is no allegation of any effort to contact the former attorney to ascertain the status of the litigation at any point or even to provide the court below with any explanation for his failure to oppose the motion for summary judgment.

Id. at 739, 741. We concluded that the default was properly allowed to stand since the record was "bereft of any indication of client diligence." Id. at 741. See also Dominguez v. United States, 583 F.2d at 618 (upholding refusal to vacate default where "there [wa]s no particularized showing of exceptional circumstances explaining [counsel's] gross negligence and no indication of diligent efforts by appellant to induce him to fulfill his duty" (emphasis added)). In sum,

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where the attorney's conduct has been found to be willful, the willfulness will be imputed to the party himself where he makes no showing that he has made any attempt to monitor counsel's handling of the lawsuit.

In United States v. Cirami, 563 F.2d 26 (2d Cir. 1977) ("Cirami II"), we considered the Cirami I defendants' post-Cirami I renewed motion to vacate the default. The renewed motion, unlike the original motion, was supported by affidavits asserting, inter alia, that the defendants had in fact, through an intermediary, diligently inquired of their attorney as to the status of their case "three or four times a week" over a six-month period and that the attorney had given assurances on each occasion that the matter was being handled properly. Id. at 33. We ruled that, if established, these assertions would provide ground for not holding the defendants responsible for their attorney's neglect, and we remanded for a hearing as to the truth of the defendants' assertions. See also Vindigni v. Meyer, 441 F.2d 376, 377-78 (2d Cir. 1971) (vacating a dismissal for failure to prosecute where the defaulting party's attorney had apparently "disappeared" during pretrial proceedings, and remanding for findings as to the truth of party's allegation that he had made diligent attempts to locate the attorney).

In the present case, the district court properly found that Shanklin had made no showing of diligence that would warrant relieving him of the default judgment. Though Shanklin's memorandum of law stated that "Shanklin, by his own conduct, has done everything in his power to reverse the

consequences of Rucker's outrageous incompetence" (Shanklin Memorandum at 23 (emphasis added)), neither the memorandum nor his affidavit gave any indication that Shanklin had done anything whatever to prevent the default's occurrence. For example, although Shanklin stated in his affidavit that he had placed some 20 calls to Rucker in the wake of the default judgment, he did not suggest that he had discussed the case with Rucker at all from the time the case was commenced in October 1994 until the default was entered in September 1995, or that he had made any effort to reach Rucker during that nearly one-year period. Similarly, although Shanklin indicated in his affidavit that he believed Rucker was preparing a motion to vacate the default, in part because Rucker billed him for alleged services on such a motion, Shanklin did not state, suggest, or in any way intimate that he had received any bills from Rucker with respect to the lawsuit at any time prior to the default. Thus, the record reveals a party who by his own description is a sophisticated businessman, who after being sued by the SEC apparently did not talk to his attorney for nearly a year, and who apparently received no bills during that time to indicate that any attention was being given to his case. We see no basis on which to overturn the district court's conclusion that the willful default of Rucker should be imputed to Shanklin.

B. Meritorious Defense

In order to make a sufficient showing of a meritorious

defense in connection with a motion to vacate a default judgment, the defendant need not establish his defense conclusively, see, e.g., Davis v. Musler, 713 F.2d at 916, but he must present evidence of facts that, "if proven at trial, would constitute a complete defense," Enron Oil Corp. v. Diakuhara, 10 F.3d at 98. We see no error in the district court's assessments, set out in detail in Part I.B. above, that Shanklin's denials of scienter would not constitute such a defense.

First, the court's ruling that lack of scienter would not be a defense to the claims under § 13 and the regulations thereunder was consistent with precedent in this Circuit and with the Commission's interpretive regulations indicating that scienter is not an element of civil claims under those provisions. See generally SEC v. Koenig, 469 F.2d 198, 200 (2d Cir. 1972) (upholding finding of § 13(a) liability, without mention of scienter, of top corporate officer for failure to include required information in SEC reports); "Promotion of the Reliability of Financial Information and Prevention of the Concealment of Questionable or Illegal Corporate Payments and Practices," Exchange Act Release No. 34-15570, 16 S.E.C. Docket 1143, 1151, 1979 WL 17892 at *9-*10 (February 15, 1979) (no scienter requirement inserted in SEC Rule 13b2-1, 17 C.F.R. § 240.13b2-1, because § 13(b) of the 1934 Act "contains no words indicating that Congress intended to impose a 'scienter' requirement"). The Commission's interpretations of § 13 and of its own regulations thereunder are entitled to deference. See, e.g.,

Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984) (mandating deference to administering agency's reasonable statutory interpretations); Bowles v. Seminole Rock & Sand Co., 325 U.S. 410, 417-18 (1945) (same with respect to agency's interpretation of its own regulations). Further, the district court's view that scienter is not a prerequisite to civil liability under § 13 is supported by the fact that in 1988, Congress amended § 13(b) to provide that "knowing[]" falsification is required before "criminal liability shall be imposed," Foreign Corrupt Practices Act Amendments of 1988, Pub. L. No. 100-418, § 5002, 102 Stat. 1415, 1415 (1988) (codified at 15 U.S.C. § 78m(b) (1994) (emphasis added)); see also H. Conf. Rep. 100-576, at 916 (1988), reprinted in 1988 U.S.C.C.A.N. 1547, 1949-50, plainly implying that falsification of the information to be filed in accordance with § 13(b) need not be knowing in order to lead to civil liability.

Second, the scienter needed for proof of a claim under § 10(b) or Rule 10b-5, see Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976), may be established through a showing of reckless disregard for the truth, see Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 46 (2d Cir.), cert. denied, 439 U.S. 1039 (1978), that is, "conduct which is 'highly unreasonable' and which represents 'an extreme departure from the standards of ordinary care.'" Id. at 47. The district court's finding that Shanklin displayed at least a reckless disregard for the truth is well supported by the evidence, including Shanklin's own affidavit, that he included false statements in

SEC filings notwithstanding the obviously evasive and suspicious statements made to him by McNulty and Thompson, and notwithstanding the advice given to him by outside counsel that he should omit those statements.

Finally, Shanklin argues also that it was inappropriate for the district court to grant injunctive relief against him. The appeal from the denial of a motion to vacate pursuant to Rule 60(b) brings up for review only the validity of that denial, not the merits of the underlying judgment itself. See, e.g., Browder v. Director, Department of Corrections of Illinois, 434 U.S. 257, 263 n.7 (1978); Davis v. Musler, 713 F.2d at 912; Cirami I, 535 F.2d at 741. We thus doubt that the question of the propriety of the injunction is properly before us on this appeal. To the extent that the appropriateness-of-relief issue is properly before us, however, we note that it is within the district court's discretion to enter such an injunction if it considers that relief warranted by a culpable defendant's "continued protestations of innocence," SEC v. Lorin, 76 F.3d 458, 461 (2d Cir. 1996) (per curiam), and we see no abuse of discretion here, given Shanklin's efforts to shift responsibility to others and his persistent denial, notwithstanding the record evidence of scienter, of any culpable conduct.

CONCLUSION

We have considered all of Shanklin's contentions on this appeal, and have found in them no basis for reversal. The order of the district court denying the motion to vacate is affirmed.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

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At a Stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 3rd day of March, one thousand nine hundred and ninety-eight.

PRESENT: HON. Amalya L. Kearse
HON. Richard J. Cardamone
Circuit Judges
HON. Peter K. Leisure
District Judge*

Docket No: 97-6122

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellee,

-v-

ROBERT J. McNULTY, GEORGE G. HANDGIS, FRANKLIN D. ROBERTS, JOHN M. SHANKLIN and

W. N. THOMPSON,
Defendants,

JOHN M. SHANKLIN,
Defendant-Appellant.

Appeal from United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the Southern District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby **ORDERED**, **ADJUDGED**, and **DECREED** that the order of said district court be and it hereby is affirmed in accordance with the opinion of this court.

For the Court
GEORGE LANGE III, Clerk
By:
/s/ Beth J. Meador
Beth J. Meador
Administrative Attorney

The Honorable Peter K. Leisure, of the United states District Court for the Southern District of New York, sitting by designation.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

At a stated term of the United States Court of Appeals for the Second Circuit., held at the United States Courthouse, Foley Square, in the City of New York, on the is 18 day of May one thousand nine hundred and ninety-eight.

S E C

v Dkt No: 97-6122

McNulty

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by the appellant JOHN M. SHANKLIN

> Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED**.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges for the court in regular active

service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT
GEORGE LANGE III, Clerk

By: /s/ Beth J. Meador
Beth J. Meador,
Administrative Attorney

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff,

v.

Robert McNULTY, George J. Handgis, Franklin D. Roberts, John M. Shanklin, and Willard N. Thompson,
Defendants.

No. 94 CIV. 7114 (MBM).

United States District Court, S.D. New York.
July 29, 1996.

Carmen J. Lawrence, Robert B. Blackburn, Ellen N. Hersh, Anahaita N. Kotval, James P. Bodovitz, New York City, for Plaintiff.

Jack I. Samet, Gregg A. Rapoport, Baker & Hostetler, Los Angeles, California, for Defendant John M. Shanklin.

OPINION AND ORDER

MUKASEY, District Judge.

On September 11, 1995, this court entered a default judgment against defendant John Shanklin in this action. Shanklin now moves to set aside that judgment pursuant to Fed.R.Civ.P. 55(c). Because Shanklin has not shown good

cause to set aside the default judgment, his motion is denied.

I.

In Fall 1991, the Securities and Exchange Commission ("SEC") began to investigate the financial affairs of HQ Office Supplies Warehouse, Inc. ("HQOS"), its subsidiary, HQ Office International, Inc. ("HQOI"), AG Automotive Warehouses, Inc. ("Auto Giant") and Auto Depot, Inc. ("Auto Depot"). These affiliated companies had common directors, management and consultants, and are collectively referred to herein as the "McNulty entities" because they were all run by former defendant Robert McNulty.[1] (Compl. ¶ 1)

As a result of its investigation, the SEC found that the McNulty entities had filed false and misleading documents with the Commission, including registration statements filed in connection with public offerings of stock between 1988 and 1990, as well as subsequent annual and quarterly reports. (Id. ¶2) The McNulty entities' finds allegedly were not used for starting operations or opening stores as was stated in those entities' SEC filings. Instead, a significant portion of the McNulty entities' assets allegedly had been loaned or transferred to affiliated companies, to the entities' underwriter

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[1]On October 6, 1995, Robert McNulty was dismissed as a defendant under a consent judgment ordering him to cooperate further with the SEC. (Final Judgment of Permanent Injunction and Other Relief by Consent against Robert McNulty)

Global America, Inc., to related parties and to McNulty himself, transactions not disclosed in the entities' SEC filings. (Id.)

John Shanklin's involvement with the McNulty entities began in 1990, when he served as a consultant to HQOS, HQOI, Auto Depot, Auto Giant and Familia Mercado, another McNulty entity. McNulty served as Chairman of the Board of all five of these start-up firms. (Shanklin Aff. ¶ 27(d)) In November 1990, Shanklin became Auto Giant's Chief Operating Officer, ("COO") and in April 1991, he became its Chief Executive Officer ("CEO"). (Compl. ¶ 18) In January 1991, Shanklin became President, Chief Financial Officer ("CFO") and CEO of Auto Depot. (Id.) At that time Shanklin also served on the Board of Directors of HQOI, Auto Giant and Auto Depot. (Id.) Shanklin remained with Auto Giant and Auto Depot until February 1992. (Shanklin Aff. 129)

As CEO of Auto Giant and Auto Depot, Shanklin helped to prepare and file those companies' registration statements and annual and quarterly reports. The SEC alleges that Shanklin falsified the companies' books and records and lied to the companies' outside auditors about intercompany and affiliate transactions. (Compl. ¶ 3) For example, the SEC charges that Auto Giant falsely stated in its quarterly report for the period ending September 30, 1990, ("the November 1990 Filing") that its $300,000 transfer to Auto Holdings was used to acquire sites for Auto Giant stores. According to the SEC, those funds were actually transferred

to Global America, a company that served as an underwriter for the McNulty entities. (Id. ¶¶ 25, 55) Moreover, the SEC contends that Shanklin knew that the disclosure in the November 1990 filing was materially false. (Id. 156)

The November 1990 filing also disclosed a transfer of $805,000 from Auto Giant to Centaur, another company formed by McNulty. The form falsely stated that the transfer's purpose was to secure sites for new stores, when in fact the funds were used to purchase securities for Centaur. (Id. 160-62) The SEC alleges that Shanklin knew about that material misrepresentation too. (Id.)

In May 1991 Shanklin helped to prepare annual reports for various McNulty entities. The SEC alleges that in these reports, Shanklin knowingly failed to disclose transfers of funds between the McNulty entities, and the extent of the financial interdependence among the companies. (Id. ¶ 68-72) On September 30, 1994, the SEC brought this action against McNulty and four other individuals, among them John Shanklin, seeking injunctive relief and civil monetary penalties pursuant to 15 U.S.C. § 78u. The SEC alleged that Shanklin violated the antifraud and disclosure provisions in §§ 10(b), 13(a) and 13(b) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78m(a) and (b). (Id. 1194-98, 106-09)

Shanklin was served with the complaint on or about October 28, 1994, and immediately gave it to Fred Rucker, then his attorney. (Shanklin Aff. ¶ 6) Shanklin never answered the complaint, and Rucker failed to appear at any of

the pretrial conferences. (Id. Ex. R ¶¶ 3-4)

Rucker similarly failed to respond to the SEC's repeated warnings that it planned to seek a default judgment. SEC attorney James Bodovitz informed Rucker by letters dated April 26 and June 26, 1995, that the SEC would seek a default judgment if Shanklin did not answer the complaint. (Id. Exs. G, H) Rucker did not reply. Shanklin claims he was unaware of those letters, or of Rucker's failure to respond to them, until April 19, 1996, seven months after the default judgment was entered. (Id. ¶ 11)

On September 11, 1995, 11 months after the complaint was filed, this court entered a default judgment against Shanklin. That judgment enjoined Shanklin from violating sections 10(b) and 13(a) and 13(b) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78m(a) and 78m(b). (Final Judgment by Default at 1-3) Shanklin was ordered also to pay civil monetary penalties pursuant to section 21 of the 1934 Act, 15 U.S.C. § 78u(d)(3) (1994), in an amount to be determined by a 'Magistrate Judge. (Id. at 3) The final judgment was served on both Shanklin and Rucker.

On or about September 18, 1995, Shanklin received a copy of the default judgment. (Shanklin Aff.Ex. 1) He claims that he placed approximately 20 telephone calls to Rucker, but was unable to reach him over the following seven days. (Id. Ex. K) On September 29, Shanklin acknowledged receipt of the default judgment by affidavit sent to the SEC. (Id. Ex. J)

After the judgment was entered, Rucker told Shanklin

he intended to file a motion to set aside the default judgment, (id. Ex. 0) claimed he did so, and even billed Shanklin in November 1995 for preparing and filing a motion. (Id. Ex. P) In fact, and unbeknownst to Shanklin until April 1, 1996, Rucker never filed the motion. (Id. ¶¶ 17-18, 20) When Shanklin discovered that Rucker had misled him and had failed to move to set aside the default judgment, he immediately dismissed Rucker and retained new counsel. (Id. ¶¶ 22-24)

Shortly thereafter, on May 16, 1996, Shanklin filed the present motion. He claims the judgment against him was obtained without his knowledge, through no fault of his own, and solely as a result of his former lawyer's incompetence. (Id. ¶ 2)

II.

Fed.R.Civ.P. 55(c) provides that "[f]or good cause shown the court may set aside an entry of default and, if a judgment by default has been entered, may likewise set it aside in accordance with Rule 60(b)." Rule 60(b) allows the court to grant relief from a final judgment for the following reasons:

(1) mistake, inadvertence, surprise or excusable neglect;

(2) newly discovered evidence which by due diligence could not have been discovered in time to move for a new trial under Rule 59(b);

(3) fraud, misrepresentation, or other misconduct of an

adverse party;
(4) the judgment is void;
(5) the judgment has been satisfied, released or discharged; or
(6) any other reason justifying relief from the operation of the judgment.
Fed.R.Civ.P. 60(b). Defendant relies on Rule 60(b)(l) and 60(b)(6) to argue that the judgment against him should be set aside. Shanklin Mem. at 19)

Motions to vacate default judgments "are left to the sound discretion of the district court, because it is in the best position to assess the individual circumstances of a given case and to evaluate the credibility and good faith of the parties." Enron Oil Corp. v. Diakuhara, 10 F.3d 90, 95 (2d Cir.1993). The Second Circuit has established a three-part test to guide the exercise of that discretion. The court must consider (1) whether the default was willful, (2) whether setting aside the default would prejudice the plaintiff, and (3) whether the defendant has presented a meritorious defense to the action. Id. at 96. The court must consider all three of these factors. Commercial Bank of Kuwait v. Rafidain Bank, 15 F.3d 238, 243 (2d Cir. 1994). Moreover, the district court should apply these factors generously, and resolve any doubts in favor of the defaulting party. Enron 10 F.3d at 96.

A. Willful Conduct

The first factor inquires whether the defendant was culpable in the entry of the default judgment--i.e., whether he

willfully refused to respond to the complaint. This factor is relevant but not dispositive; "[e]ven when defendant's conduct may be considered 'willful,' a default judgment against him may be vacated if he presents valid defenses and plaintiff would not be prejudiced if the default judgment was vacated." Wagstaff-El v. Carlton Press Co., 913 F.2d 56, 57 (2d Cir.1990), cert. denied, 499 U.S. 929 (1991).

Here, Shanklin claims that the default judgment against him was procured as a result of excusable neglect rather than culpable conduct. He contends that the default judgment was entered as a result of Rucker's gross negligence, of which he was unaware until April 1996. (Shanklin Aff ¶¶ 3-22) Rucker, apparently, was aware that the court might enter a default judgment against his client and took no steps to prevent it. The issue, then, is whether Rucker's willful conduct may be imputed to Shanklin.

Shanklin argues that Rucker's knowledge of the SEC's plans to seek a default judgment cannot be imputed to him, because "[t]hird party disclosure to an agent is not imputed to the principal when the agent is acting adversely to the principal's interest and the third party had notice of this." Arlinghaus v. Ritenour, 622 F.2d 629, 636 (2d Cir.), cert. denied, 449 U.S. 1013 (1980). (holding that corporate officers' disclosure of shares' value to a shareholder's attorney cannot be imputed to the shareholder, since the officers were aware of the attorney's self-interested scheming with respect to his client's shares.) But this principle does not apply here, where a defendant seeks relief from a default judgment,

because the Second Circuit "has rather consistently refused to relieve a client of the burdens of a final judgment entered against him due to the mistake or omission of his attorney . . . or his inability to efficiently manage his caseload." United States v. Cirami, 535 F.2d 736, 739 (2d Cir.1976). "Absent a truly extraordinary situation . . . the client is not excused from the consequences of his attorney's nonfeasance." Chira v. Lockheed Aircraft Corp., 634 F.2d 664, 666 (2d Cir.1980).

In Dominguez v. United States, 583 F.2d 615 (2d Cir.1978), cert. denied, 439 U.S. 1117 (1979), the Second Circuit held that a client was bound by the dismissal of her action that resulted from her counsel's failure to appear at pretrial conferences and his failure to move to vacate the dismissal for over ten months after receiving notice of the court's order. Id. at 618. There, the Court held that the attorney's behavior was so grossly negligent and irresponsible that it could not be characterized as excusable neglect within the meaning of Rule 60(b). Id. at 617. Further, the Court held that the client was bound by her attorney's conduct because there was "no indication of diligent efforts by [client] to induce him to fulfill his duty." Id. at 618.

Here, Rucker's conduct is strikingly similar to that of the attorney in Dominguez. His failure to respond to the complaint, his failure to appear at pretrial conferences, and his failure to move to set aside the default judgment despite billing his client for preparing a motion, all amount to grossly negligent behavior that cannot reasonably be characterized as excusable neglect. In addition, there is no evidence that

Shanklin diligently induced Rucker to fulfill his duty. Shanklin does not show that he discussed the suit with Rucker at any time between October 1994 and September 1995. Absent Shanklin's diligent efforts to induce Rucker to fulfill his duty, Shanklin is bound by Rucker's willful conduct. Rucker's egregious conduct may warrant a malpractice suit, but Shanklin's failure to monitor that conduct does not justify relieving him of the default judgment.

B. Prejudice to the Nondefaulting Party

In determining whether plaintiff would be prejudiced by the granting of the motion to vacate the default judgment, "delay alone is not a sufficient basis for establishing prejudice. . . . Rather, it must be shown that delay will result in the loss of evidence, create increased difficulties of discovery, or provide greater opportunities for fraud and collusion." Davis v. Musler 713 F.2d 907 916 (2d Cir. 1983).

The SEC contends that to allow a defendant who ignored a complaint for 11 months, and who ignored a default judgment for seven more months, to reappear and set aside the default judgment soon before the trial of George Handgis, another defendant in the case, would result in substantial prejudice to the Commission. The SEC has conducted no discovery with respect to Shanklin--it conducted no discovery prior to his default due to his failure to appear, and no discovery after his default in light of his failure to move promptly to vacate the judgment. (PI.Mem. at 6) Setting

aside the default judgment, the SEC contends, would require it to conduct discovery with many of the same individuals and entities as it has already done in preparation for the Handgis trial. However, the SEC has not shown that such delay would result in a loss of evidence or provide opportunities for fraud or collusion. Therefore, this factor weighs only slightly in favor of the SEC.

C. Meritorious Defenses

To show that a defense has merit, and thereby to meet the third part of the test, "a defendant seeking to vacate a default judgment need not conclusively establish the validity of the defense(s) asserted," Davis, 713 F.2d at 916, "but must make some showing of their existence other than mere allegations." Tecnart Industria e Comercio Ltda. v. Nova Fasteners Co., 107 F.R.D. 283, 285 (E.D.N.Y.1985). Conclusory statements do not suffice; "the moving party . . . must support its general denials with some underlying facts." Sony Corp. v. Elm State Electronics, Inc., 800 F.2d 317, 320 (2d Cir.1986). See also 6 James Wm. Moore et al., Moore's Federal Practice 1 55.10 (2d ed. 1996). (These should be "specific facts that, if proven at trial, would constitute a defense to the claim asserted.") Another Court in this District held that a defendant must "articulate a defense with a degree of specificity which directly relates that defense to the allegations set forth in the plaintiff's pleadings and raises a 'serious question' as to the validity of those allegations."

Salomon v. 1498 Third Realty Corp., 148 F.R.D. 127, 130 (S.D.N.Y.1993).

1. Section 10(b) Claim

In his defense, Shanklin argues that each of the claims against him requires a showing of scienter, and that the SEC cannot make that showing. (Shanklin Aff.Ex. S) Scienter is "a mental state embracing intent to deceive, manipulate or defraud. " Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193-94 (1976). Claims under § 10(b) of the Securities Exchange Act do in fact require a showing of scienter on the part of the defendant. Id.

Shanklin claims he lacked the requisite state of mind, because he "had no knowledge of wrongdoing at time the violative acts occurred." (Shanklin Aff.Ex. S) He contends that as to the November 1990 filing, he was lied to and misled by others in his efforts to learn the facts surrounding the transactions being disclosed, and as to the January 1991 filing, it was prepared by corporate counsel and outside auditors, and he learned only years later that it disclosed incorrect or incomplete information. (Id. ¶¶30-34)

Shanklin claims that when he joined the McNulty entities in October 1990, he was unaware of McNulty's dishonest practices concerning intercompany transfers. He claims that McNulty and the other defendants had been connected for some time through interlocking companies and were involved in the preparation of SEC filings before

Shanklin arrived. (Id. I 34(b)) Shanklin states also that McNulty intimidated his subordinates and kept them ill-informed of his decisions. (Id. ¶ 34(c))

Yet Shanklin admits he drafted the false Auto Giant quarterly report in November 1990 ("the November 1990 filing"), and admits also that he knew McNulty wanted to conceal a transfer of $805,000 from Auto Giant to Centaur. (Id. ¶¶ 30(b), 30(c)) According to Shanklin, in November 1990, when he learned of the $805,000 transfer to Centaur, he asked McNulty for information about it. McNulty told him not to disclose the transaction, refused to provide further information, and called him derogatory names. (Id. ¶ 30(b)) In a meeting later that day or the following day, Shanklin told McNulty he would nevertheless report the transaction on the November 1990 filing, (Id.) and McNulty allegedly told him that the transfer's purpose was to fund deposits on real estate leases. (Id. I 30(c)) McNulty referred Shanklin to defendant Willard Thompson, but Thompson "was evasive and refused to provide detail about Centaur's purported use of the Auto Giant funds to secure real estate leases. For example, he would not tell me who the landlords on the leased properties were, or the terms of the leases." (Id. I 30(e))

In addition, in his deposition on April 3, 1996, Michael Cross, an attorney at Cooper & Dempsey, testified that he reviewed Shanklin's draft of Auto Giant's November 1990 filing, questioned its truthfulness, requested an explanation from Shanklin, and advised Shanklin that the document should not be filed with the Commission.

(Bodovitz Decl. 1 7, Ex. 4) Despite Thompson's evasive response and Cross's advice, Shanklin filed the form with the SEC.

Although Shanklin claims he did not learn the information McNulty had given him was incorrect until after an internal investigation later disclosed that the funds actually went to Global to buy securities for Centaur (id. ¶ 30(f)), Shanklin had good reason to be suspicious of McNulty's statement when Thompson showed reluctance to provide further information. That McNulty and Thompson both refused to provide him with relevant information should have alerted Shanklin to the likelihood of material omissions and misrepresentations in the November 1990 filing that he prepared. Shanklin cannot "escape liability for fraud by closing his eyes to what he saw and could readily understand." Securities & Exch. Comm'n v. Frank, 388 F.2d 486, 489 (2d Cir.1968). Shanklin's conscious avoidance of knowledge satisfies the scienter requirement. See Securities & Exch. Comm'n v. Musella, 678 F.Supp. 1060, 1063 (S.D.N.Y. 1988); In re Fischbach Corp. Secs. Litig., No. 89 Civ. 5826, 1992 WL 8715, *5 (S.D.N.Y. Jan. 15,1992) ("A defendant who is found to have 'deliberately shut his eyes' to the facts will not be allowed to use the excuse of ignorance, and will be held to have scienter. ")

In sum, Shanklin does not sufficiently demonstrate that he lacked the requisite scienter so as to present a meritorious defense that would relieve him from the default judgment. While he may not have known the precise details

of the transactions McNulty sought to conceal, or the reason McNulty sought to conceal them, he knew that the disclosure forms he prepared and signed were inaccurate and omitted material information.

2. Section 13 Claims

Scienter is not required to prove violations of §§ 13(a) and 13(b) of the Securities Exchange Act. Section 13, 15 U.S.C. § 78(m), requires every issuer of a security registered on an exchange to file with the Commission: (1) any information the Commission may require in order to keep information already filed reasonably current, and (2) annual and quarterly reports required by the rules and regulations of the Commission. In addition, every issuer must keep books, records and accounts that reflect, accurately and in reasonable detail, transactions and dispositions of assets of the issuer. A violation of § 13 occurs when reports contain information that is materially false or misleading, or omit material facts.

Section 13 mandates disclosure of information to provide protection for stockholders and investors. it contains no language suggesting that Congress intended to require a scienter showing before a defendant could be found to have violated it. After comparing § 13(d)'s language with § 10(b) of the same statute, the D.C. Circuit concluded that the SEC can establish that a violation of § 13(d) has occurred without showing scienter. According to the D.C. Circuit, the holding in Ernst & Ernst that a § 10(b) violation requires scienter

"rested, in large part, upon an analysis of the language of . . . the legislative history, [and] the legislative intent, [of] section 10(b) vis-a-vis other provisions in the statutory scheme . . . In its analysis of section 10(b), the Supreme Court seized upon that section's use of the words "manipulative," "deceptive" . . . None of these terms is present in section 13(d)(1)." Securities & Exch. Comm'n v. Savoy Industries, 587 F.2d 1149, 1167 (D.C.Cir.1978), cert. denied, 440 U.S. 913 (1979). In Securities & Exch. Comm'n v. Wills, 472 F.Supp. 1250, (D.D.C.1978), the D.C. District Court applied the same analysis to § 13(a): "Section 13(a), like § 13(d)(1)." is a reporting, and not an anti-fraud, provision . . . § 13(a) gives no hint that intentional conduct need be found, but rather, appears to place a simple and affirmative duty of reporting on certain persons. " Id. at 1268. Because scienter is irrelevant to the § 13 claims against Shanklin, and he admittedly filed false and incomplete disclosure forms with the SEC, he is liable under that section.

Shanklin's proffered defense as to the January 1991 form also lacks merit. Shanklin claims that he did not prepare Auto Giant's January 1991 amended quarterly report, ("the January 1991 filing") himself, but rather that it was prepared by the law firm Cooper & Dempsey and reviewed by auditors at Deloitte & Touche. (Shanklin Aff. I 33(b)) Cooper & Dempsey and Deloitte & Touche were working with HQOS's independent investigative counsel, LeBoeuf, Lamb, Greene & MacRae, to prepare the January 1991 filing. According to Shanklin, Auto Giant's management relied on Cooper &

Dempsey and Deloitte & Touche to make accurate disclosures. (Id.) But Shanklin signed the form, and as the chief officer of Auto Depot and Auto Giant, and a sophisticated businessman, he is held responsible for the accuracy of the information therein. Shanklin cannot escape that responsibility by entrusting the preparation of the filings to a professional. Cf. Olsen Associates, Inc. v. United States, 853 F.Supp. 396, 401 (M.D.Fla.1993) ("As a general rule, the duty of filing accurate returns cannot be avoided by placing responsibility on a tax return preparer. ")

The other defenses that Shanklin presents also would not shield him from liability on the claims against him if presented at trial, and thus do not justify setting aside the default judgment. First, Shanklin claims he did not profit from any of the alleged illegal transactions or nondisclosures that are the basis of the SEC's claims against him, and that, in fact, he lost $30,000 he had invested in now-worthless founder's stock acquired from departing executives of the McNulty entities in December 1990. (Shanklin Aff. 1 35) But an individual's failure to reap gain from illegal financial activity does not establish a legal defense, any more than an empty purse would exonerate the pursesnatcher. Shanklin also claims he would not have made the $30,000 investment had he known of any wrongdoing or improper disclosures. (Id.) Yet his losing investment does not prove that he had no knowledge of the illegal activities by the McNulty entities, only that he hoped those entities would generate profits.

Second, Shanklin contends that the default judgment

has precluded him from obtaining employment in the management of any publicly-held corporation. (Id. ¶ 12) However, according to the SEC, Shanklin serves as President and Director of a company known as "Interactive Buyers Network International Ltd." ("IBNL") and, in October 1995, filed forms with the SEC reflecting sales of IBNL securities. (Bodovitz Decl. 18, Ex. 5) Shanklin has presented no evidence to dispute this.

Third, Shanklin claims there is no reason to believe that he would violate the federal securities laws in the future. Indeed, among the factors the court may consider in determining whether to issue an injunction to prevent future violations of securities laws are "the likelihood of future violations, sincerity of defendants assurances against future violations . . . and likelihood, because of defendant's professional occupation, that future violations might occur." Securities & Exch. Comm'n v. Universal Major Industries Corp., 546 F.2d 1044, 1048 (2d Cir.1976) cert. denied, 434 U.S. 834 (1977). But these factors are not dispositive. Shanklin asserts that in 20 years of senior management, and 30 of over-all corporate management, he has prepared and signed numerous securities filings and has never been criticized or questioned about their accuracy prior to this case. (Shanklin Aff. 1 37) However, neither absence of past violations of securities laws, nor Shanklin's assurances that he would not commit such violations in the future, are conclusive indicators of the likelihood of future violations. Indeed, Shanklin's refusal to recognize his culpability in

signing documents whose veracity he had no basis to certify and every reason to doubt shows he has learned nothing from this episode and therefore is likely to repeat it. Because it is difficult to discount the likelihood of future violations, an injunction is warranted.

* * *

Because Shanklin has failed to show that the default judgment was not obtained as a result of willful conduct, that setting it aside would not prejudice plaintiff, or that he has a meritorious defense to the SEC's claims, his motion to set aside the default judgment is denied.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF
NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	)	
Plaintiff,	)	
	)	94 Civ. 7114
	)	(MBM)
-against-	)	ORDER
	)	
ROBERT J. McNULTY GEORGE G. HANDGIS, FRANKLIN D. ROBERTS, JOHN M. SHANKLIN, and W.N. THOMPSON,	)	
Defendants.	)	
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MICHAEL B. MUKASEY, U.S.D.J.

The above-captioned case was referred to Magistrate Judge Henry Pitman to conduct an inquest to determine the civil penalty to be assessed against defendant John M. Shanklin and to issue a report and recommendation as to his findings. The parties by stipulation agreed that there was no need for an evidentiary hearing and that the matter could be decided on the parties' papers and oral argument. Magistrate Judge Pitman filed his report describing the reasons why

defendant Shanklin should be assessed $7,500.00, and sent it to the parties on September 30, 1996. As of this date the Court has not received any objection to Magistrate Judge Pitman's Report and Recommendation. Accordingly, and because the report is not facially erroneous, the Court affirms and adopts it. Therefore, defendant John M. Shanklin is to pay $7,500.00 as a civil penalty.

SO ORDERED:
/s/ Michael B. Mukasey
Michael B. Mukasey,
U. S. District Judge

Dated: New York, New York
March 20, 1997